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Pension World

The Magazine for Plan Sponsors and Investment Managers/ A Publication of Communication Channels, Inc.

The Travelers Insurance Co.: Can bottom-up management improve performance?

Fifth Annual Directory of Insurance Company Employee Benefits Services

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NEWS Pension World

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TUCS shows markets outpaced managers

■ Three-quarters of the equity portfolios in the Trust Universe Comparison Service (TUCS) database underperformed the market for the first quarter of 1984 as represented by the Standard & Poor's 500-Stock Index. Fifty-four percent of the fixed-income portfolios underperformed the Lehman Government/Corporate Index. The median equity portfolio returned −5.1 percent, while the median fixed-income portfolio returned 0.4 percent. The median balanced portfolio returned −1.9 percent.

Over a period of five years, active managers have performed somewhat better than the general markets. The median equity portfolio returned 15.9 percent annually, versus the S&P 500 return of 15.0 percent; and the median bond portfolio returned 9.6 percent annually, versus the Lehman Government/Corporate return of 9.4 percent.

TUCS is a database of over 3,300 investment portfolios, representing approximately 300 money managment firms and over $200 billion in assets. Thirty-five banks and insurance companies participate in TUCS.

Total Rates Of Return
Periods Ending March 31, 1984

	Current Quarter	1 Year	3 Years*	5 Years*
Balanced Funds				
Median	−1.9%	4.9%	12.0%	12.7%
Equity Funds				
Median	−5.1%	2.9%	10.7%	15.9%
S&P Index	−2.4% (25)	8.6% (28)	10.7% (50)	15.0% (59)
Fixed-Income Funds				
Median	0.4%	4.8%	14.0%	9.6%
Lehman Government/ Corporate Index	0.5% (46)	5.2% (42)	14.9% (30)	9.4% (56)

( ) Percentile Ranking
*Annualized

Self-insurance: key to health costs?

■ Self-insurance may be a key in controlling the rise in health care cost for employers, according to a survey by the Bureau of National Affairs, Inc. (BNA). The report, entitled "Health and Life Insurance Benefit Plans," reveals that nearly half of all employers providing health insurance to their work forces now self-insure at least part of their medical benefits package. Firms that have reported significant cost savings, attribute their success to self-insuring the benefit plans.

The Personnel Policies Forum, a panel of human resources executives representing a cross section of U.S. industry, surveyed 221 employers and found that 46 percent of the employers that provide health benefit plans to plant or service workers, fund at least part of their benefits package through self-insurance, compared to only eight percent self-insuring health benefits in 1978.

The extent of concern about the escalation of benefit costs is reflected in the survey's finding that 81 percent of the 221 responding firms had recently taken or were planning to take steps to reduce their health plan costs, compared with 34 percent of employers in 1978.

Other results from the survey showed:

- all of the employers responding to the survey provide group life insurance benefits and medical expense benefits to their employees;
- more than one-third of the responding employers have separate plans providing base hospital/surgical benefits and major medical coverage.

Northwestern Nat'l offers new service

■ Through an affiliation with the Frank Russell Investment Management Co., Tacoma, Wash., the Northwestern Bank of Greensboro, N.C., now offers its tax-exempt trust customers shares of six distinct investment funds and a computerized asset allocation model.

Walton C. Jennette, senior vice president and manager of Northwestern's Trust Division, said, "Through the computerized asset allocation model and the six separate investment funds (three equity funds, two fixed-income funds, and an international fund), our trust officers will work with their customers to create investment programs specifically designed for the special needs and investment goals of each individual account."

International Pension World

Switzerland braces for new pension legislation

The new Swiss Pension Legislation, which becomes effective as of January 1, 1985, was enacted in 1982 after considerable discussion at both the Federal and cantonal levels. Employers who have plans now will have up to five years to bring these plans into line with the new legislation. However, the requirement for equal employee representation on the administrative committee of the pension fund must be implemented effective January 1, 1985. This will limit an employer's ability to decide how to implement plan changes. Accordingly, all employers in Switzerland need to review their pension arrangements, both to assure compliance with the new rules and to take advantage of some relatively recent changes in the Swiss investment climate.

Table 1 Total Contributions by Age

Male Age	Female Age	Percent of Covered Earnings* 1st & 2nd Year	Thereafter
25-34	25-31	7%	7%
35-44	32-41	10	10
45-54	42-51	11	15
55-65	52-62	13	18

*between SFr 16,560 and 49,680

The new law

The Swiss Second Pillar Legislation, often referred to as the BVG or LPP (the German and French acronyms for this legislation) will become effective on January 1, 1985. From that date all employers must provide certain minimum retirement benefits on pay up to SFr 49,680 (or U.S. $22,000).[1] The normal retirement benefit is based on a defined contribution formula with an interest rate of four percent. The objective is to provide a benefit of 60 percent of pay inclusive of social security. Total contributions are defined by law as indicated in Table 1, with the employer bearing at least 50 percent of the cost.

In addition, employers must pay the cost of risk benefits (1.3 percent), "special measures," including cost-of-living increases (1.0 percent), and a Guarantee Fund (0.3 percent), which add another 2.6 percent of covered payroll. The Guarantee Fund will subsidize those funds whose average costs exceed 14 percent of covered payroll.

The legislation also stipulates minimum disability pensions (equal to the expected old age pension with no allowance for future interest credit), widows' pensions (equal to 60 percent of the disability pension), and children's pensions. The accumulated contributions in an employee retirement account are fully vested and may be transferred to a new employer. Finally, there must be equal representation of employees and the company on the board of the foundation, or on the company pension committee if the plan is part of a multi-employer foundation.

Compliance issues

The new law will force changes that are more than cosmetic in all Swiss pension plans. Basically, an employer faces a crucial decision about whether to introduce the required benefits as a minimum under a more generous existing plan, or to establish a separate minimum plan, cutting back present plan benefits. (Any employer without a program offering the minimum benefits will be required to begin one.)

At first glance, employers might be tempted to fold the required benefits into an existing plan. The major advantage would appear to be simplicity of documentation and administration. But there are a number of disadvantages that apply to maintaining a single plan.

- Although the company has a single plan, the employer must keep track of the minimum benefit and its costs as if it were a separate plan. In actuality, the administration of a single plan may be more complex than it seemed at first glance.

- Few employers are eager to share control of their pension decisions with employees. Employers maintaining a single plan effectively lose control over decisions affecting the entire plan. Employers with separate plans, on the other hand, must allow equal employee representation on only the minimum benefit plan, thus keeping decision-making authority over the supplemental plan.

by **JOHN C. ROBERTS**
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Hewitt Associates
Rowayton, Conn.

[1] *Exchange rates as of May 1984.*

Table 2 Five-Year Fund Manager Performance

Year	Returns on Investment: Average Insurance Company	Bank X Pooled Fund (Balanced)	Bank Y Individually Managed Fund	Increase in Cost of Living
1979	4.2%	(0.1%)	5- 7%	3.6%
1980	4.5	5.1	7-10	4.0
1981	4.7	(0.7)	1- 2	6.5
1982	5.0	15.5	14-17	5.7
1983	5.0	12.2	14-18	2.1
Five-Year Average	4.7%	6.2%	8-11%	4.4%

• The vesting schedule for the employer's existing plan and for the new required benefits in all likelihood would differ. When the plans are combined, employers are permitted to retain the vesting rule for the entire plan as long as the minimum vested benefit required by the BVG law is being provided. This often results in a smaller vested benefit than if two separate plans are maintained. Employers in the UK are familiar with this practice, known as "franking," where it has already caused considerable controversy. If proposed legislation is enacted, franking will not be permitted in the UK in the future. There is reason to believe that franking will be just as unpopular with employees in Switzerland as with those in the UK.

Providing a separate plan

Most employers will experience a substantial cost increase as they provide for the necessary changes. Employees may better understand and accept the reason for an increase in their contribution if the minimum benefits are provided as a separate plan rather than incorporated into the existing plan.

A portion of payroll must be set aside to pay for improved benefits for the "entry generation" and for cost-of-living increases. By separating the plans, it may be simpler to apply such increases only to the legally required portion of the benefit.

A related issue employers may want to consider is the duplication of employee benefits upon disability. A new accident insurance law provides for long-term disability pensions and survivor income arising from accidents causing disability or death. Employees may also be eligible for such benefits from employer pension plans, including the benefits required by the BVG law.

As employers otherwise change their company pension plans to comply with the law, they may want to provide that the company benefit offset the benefit insured under the accident law. This ensures that a disabled employee's income will not exceed his or her prior salary. The cost savings from this change, however, will not be substantial.

Investment opportunities

In Switzerland, insurance companies have traditionally dominated the pension fund market, except for the very large funds. However, over the last several years, Swiss banks have become much more interested in the management of pension funds, setting up separate departments to handle both pooled and individually managed accounts. While bank management still may be inappropriate for the very smallest of funds, the investment manager climate in Switzerland has indeed changed from the days when only a handful of funds were not insured.

More significantly, the investment performance of Swiss banks has outpaced the insurers in recent years. Table 2 provides a snapshot comparison of representative fund managers. Data are based on five-year performance records of three Swiss insurers under their multinational pooling accounts, a "typical" pooled account, and a range of performance for an "average" individual account manager. The last column shows the low (by U.S. standards) Swiss inflation rate.

As the table illustrates, Swiss insurers have credited interest averaging 0.3 percent above the inflation rate over the past five years. The pooled fund for a bank with "average" performance earned a real return of 1.8 percent during the period. Individually managed funds (for which a minimum account of SFr 5,000,000 would be required) returned 3.6 percent to 6.6 percent above the cost of living. To a large extent the Swiss insurers have been hampered by substantially large investments in real estate which have produced below average returns in recent years. The banks have pursued a more diverse investment strategy which has helped boost their performance during the same period.

Over the last several years, Swiss banks have become much more interested in the management of pension funds, setting up separate departments to handle both pooled and individually managed accounts. The investment performance of Swiss banks has outpaced the insurers in recent years.

While the rates of return may appear to be low by U.S. standards, the differences among the managers would appear to be great enough to warrant investigation of pooled or individually-managed funds. To some extent, the data for comparison purposes may be harder to come by in Switzerland due to the traditional privacy restraints under which the banks operate. Yet the effort would appear to be worthwhile given the stronger performance of bank managers.

In summary, the Second Pillar Legislation will affect the pension plan of every Swiss employer. Because changes will be required, employers may find this an ideal opportunity to take stock of their benefit objectives and to redesign their plans to fit these objectives. □